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November 14, 2000

VIA HAND DELIVERY

Mr. K. David Waddell
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

Re: Generic Docket Addressing Rural Universal Service
Docket No. 00-00523

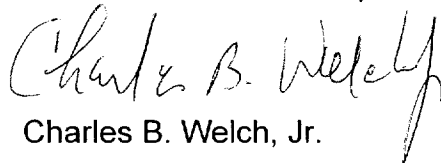
Dear Mr. Waddell:

Enclosed for filing, please find the original plus thirteen (13) copies of the Testimony of Steven E. Watkins Submitted on Behalf of the Rural Independent Coalition in the referenced docket. Copies are being served on counsel for all parties of record via facsimile this day.

If you have any questions or concerns with regard to this filing, please do not hesitate to contact me.

Very truly yours,

**FARRIS, MATHEWS, BRANAN,
BOBANGO & HELLEN, P.L.C.**


Charles B. Welch, Jr.

CBW:lw

Enclosures

cc: All parties of record

POSTED

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

IN RE:

**GENERIC DOCKET ADDRESSING
RURAL UNIVERSAL SERVICE**

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DOCKET NO. 00-00523

TESTIMONY OF

STEVEN E. WATKINS

on behalf of

**Ardmore Telephone Company
Ben Lomand Rural Telephone Cooperative, Inc.
Bledsoe Telephone Cooperative, Inc.
CenturyTel of Adamsville, Inc.
CenturyTel of Claiborne, Inc.
CenturyTel of Ooltewah-Collegedale, Inc.
Concord Telephone Exchange, Inc.
Crockett Telephone Company, Inc.
DeKalb Telephone Cooperative, Inc.
Highland Telephone Cooperative, Inc.
Humphreys County Telephone Company
Loretto Telephone Company, Inc.
North Central Telephone Cooperative, Inc.
Peoples Telephone Company, Inc.
Tellico Telephone Company, Inc.
Tennessee Telephone Company
Twin Lakes Telephone Cooperative Corporation
United Telephone Company
West Tennessee Telephone Company, Inc.
Yorkville Telephone Cooperative**

"The Coalition of Small LECs and Cooperatives"

November 14, 2000

1 TESTIMONY OF STEVEN E. WATKINS
2 DOCKET NO. 00-00523
3 NOVEMBER 14, 2000

4 Q: PLEASE STATE YOUR NAME, EMPLOYER, BUSINESS ADDRESS, AND
5 TELEPHONE NUMBER.

6 A: My name is Steven E. Watkins. I am a partner in the firm of Kraskin, Lesse & Cosson,
7 LLP. My business address is 2120 L Street, N.W., Suite 520, Washington, D.C., 20037.
8 My business telephone number is (202) 296-8890.

9 Q: ON WHOSE BEHALF ARE YOU TESTIFYING ?

10 A: I am testifying on behalf of the Coalition of LECs and Cooperatives ("Coalition"). The
11 members of the Coalition are:

12 Ardmore Telephone Company, Inc.
13 Ben Lomand Rural Telephone Cooperative, Inc.
14 Bledsoe Telephone Cooperative, Inc
15 CenturyTel of Adamsville, Inc.
16 CenturyTel of Claiborne, Inc.
17 CenturyTel of Ooltewah-Collegedale, Inc.
18 Concord Telephone Exchange, Inc.
19 Crockett Telephone Company, Inc.
20 Dekalb Telephone Cooperative, Inc.
21 Highland Telephone Cooperative, Inc.
22 Humphreys County Telephone Company
23 Loretto Telephone Company, Inc.
24 North Central Telephone Cooperative, Inc.
25 Peoples Telephone Company
26 Tellico Telephone Company, Inc.
27 Tennessee Telephone Company
28 Twin Lakes Telephone Cooperative Corporation
29 United Telephone Company
30 West Tennessee Telephone Company, Inc.
31 Yorkville Telephone Cooperative

32 The twenty (20) members of the Coalition provide local exchange and exchange access
33 services predominantly in the more rural and smaller town areas of Tennessee.

34 Q: WHAT IS YOUR CURRENT POSITION ?

35 A: My title is Principal, Management Consulting, and I am a partner in the firm of Kraskin,
36 Lesse & Cosson, LLP, which provides legal and consulting services to
37 telecommunications companies.

1 Q: WHAT ARE YOUR DUTIES AND RESPONSIBILITIES AT KRASKIN, LESSE &
2 COSSON, LLP ?

3 A: I provide telecommunications management consulting services and regulatory assistance
4 to smaller local exchange carriers ("LECs") and other smaller firms providing
5 telecommunications and related services in rural and small-town parts of the United
6 States and a limited number of foreign countries. My work involves assisting LECs and
7 related entities in their analysis of regulatory requirements and industry matters,
8 negotiating, resolving and administering connecting carrier arrangements; and assisting
9 clients in complying with the rules and regulations arising from the passage of the
10 Telecommunications Act of 1996 (the "1996 Act"). On behalf of over one hundred and
11 fifty (150) other smaller independent LECs, I am involved in regulatory proceedings in
12 several other states examining a large number of issues with respect to the manner in
13 which the 1996 Act should be implemented in those states.

14 Q: WHAT WAS YOUR EXPERIENCE PRIOR TO YOUR CURRENT POSITION ?

15 A: Prior to joining Kraskin, Lesse & Cosson, LLP, I was the senior policy analyst for the
16 National Telephone Cooperative Association ("NTCA") for 12 years, a trade association
17 whose membership consists of approximately 500 small and rural telephone companies.
18 While with NTCA, I was responsible for evaluating Federal Communications
19 Commission ("FCC") access and universal service policies and rules, the then proposed
20 1996 Act, the implementation of the 1996 Act by the FCC, and was largely involved in
21 the association's efforts with respect to the advocacy of policies and rules addressing the
22 issues specifically related to smaller LECs and their rural customers.

23 Q: HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE TENNESSEE REGULATORY
24 AUTHORITY ?

25 A: Yes. I was a witness on behalf of the Coalition members in an earlier phase of this
26 proceeding.

27 Q: DO YOU HAVE OTHER INFORMATION REGARDING YOUR BACKGROUND
28 AND EXPERIENCE ?

29 A: Yes, this information is included in Attachment I following my testimony.

30 Q: WHAT IS THE PURPOSE OF YOUR TESTIMONY ?

31 A: The general purpose of my testimony is to set forth policy analysis and conclusions with
32 respect to the issues before the Tennessee Regulatory Authority ("TRA") in this
33 proceeding (Docket No. 00-00523). This proceeding is addressing policy and regulations
34 with respect to Universal Service in areas in Tennessee served by Rural Telephone
35 Companies such as the Coalition members. I will address important policy

1 considerations with respect to the development of a State Universal Service Fund ("State
2 USF").

3 My testimony supports the Comments filed by the Coalition on September 5, 2000, in
4 this docket ("Coalition Comments"). My testimony will discuss the need for a State USF
5 in light of likely changes in the level of intrastate access charge rates.

6 My testimony is intended to highlight the public interest benefits that will accrue to rural
7 customers in Tennessee with the adoption of the access/universal service plan that the
8 Coalition proposed as the Tennessee Universal Service Rate Redesign Plan ("Plan").
9 Coalition Comments at 18-24. Implementation of the Plan would be a reasonable,
10 balanced and fair approach to address the shift in network cost recovery and the
11 preservation of Universal Service as changes in rates and revenue sources occur in the
12 intrastate and interstate arenas.

13 Q: HOW HAVE YOU ORGANIZED YOUR TESTIMONY ?

14 A: I will provide general policy discussion of the access charge and universal service issues
15 that are the immediate genesis of this proceeding. Throughout my testimony, I will
16 identify discussion of the specific "Preliminary Issues" and "Threshold Issues" that have
17 been outlined in the *Report and Recommendation of Pre-Hearing Officer* released by the
18 TRA on November 8, 2000, in this docket.

19 Q: WHAT INTERESTS DO THE COALITION MEMBERS HAVE WITH RESPECT TO
20 THE EXAMINATION OF THE ISSUES IN THIS PROCEEDING ?

21 A: The Coalition members bring to this proceeding a distinct public interest perspective.
22 The Coalition members provide telecommunications services predominantly to areas of
23 the State of Tennessee that are generally characterized by higher per-unit network costs,
24 lower customer density, and relatively lower volumes of usage. The cost of network
25 plant investment and ongoing operating expenses is greater on both a per-customer and
26 on a per-service-unit basis. Over several decades, the Coalition members have brought
27 quality telecommunications services to the rural areas of the State despite the challenges
28 presented by these characteristics. The Coalition members provide telecommunications
29 services in rural communities on a locally-operated basis, which aligns the interests of the
30 Coalition LECs and Cooperatives with those of the local customers they serve.

31 Q: IF THE NETWORK COSTS ARE GREATER AND CUSTOMER DENSITY IS
32 LOWER, HOW HAVE THESE COALITION MEMBERS BEEN ABLE TO BUILD
33 AND OPERATE NETWORKS IN THE RURAL AREAS THEY SERVE ?

34 A: The development of quality networks in the areas served by the Coalition members has
35 been aided by federal and state policies that have led to cost recovery revenue sources
36 derived from toll and access services, and more recently from explicit universal service
37 mechanisms. These cost recovery sources have allowed the Coalition members to

1 commit capital to build, operate and maintain networks in their rural service areas. The
2 regulated, primarily single-provider environment of the past afforded policy makers the
3 ability to coordinate this plan with stable, predictable, and productive results. The results
4 have led to virtually ubiquitous networks across Tennessee, the provision of advanced
5 telecommunications services to virtually all of the citizens of Tennessee, and reasonable
6 rates for all users of these services. These results have been possible through the
7 committed efforts of the Coalition members and State and federal policy makers.

8 Q: WHAT SHOULD THE OVERALL OBJECTIVE BE FOR A TENNESSEE
9 UNIVERSAL SERVICE PLAN FOR RURAL AREAS AND OTHER COST
10 ALLOCATION AND RECOVERY MECHANISMS ?

11 A: The success of both federal and state universal service plans can only be judged by the
12 results they achieve. The emphasis should be on a properly balanced approach that will
13 yield predictable and reasonable rates for all users including those in higher cost rural
14 areas. Regulatory policy should also continue to promote an environment within which
15 LECs can continue to build and operate quality networks.

16 Q: IS THERE A LINK BETWEEN POTENTIAL CHANGES IN THE INTRASTATE
17 JURISDICTION AND PENDING CHANGES IN THE INTERSTATE
18 JURISDICTION ?

19 A: Yes. There is an inescapable link between potential changes in the overall cost recovery
20 plan in Tennessee and pending changes in the interstate jurisdiction. Several of the
21 policies established by state and federal regulators are under review to ensure their long
22 term viability as competition is introduced in markets. Ultimately, the Federal
23 Communications Commission ("FCC") determines how much of a carrier's revenues will
24 come from the provision of interstate services and federal support mechanisms.
25 Accordingly, the impact on rates and cost recovery in Tennessee will be significantly
26 dependent on, and residual to, the resolution of the interstate proceedings. In general,
27 some of the various proposals under consideration at the FCC could shift additional
28 network cost recovery to the end user and to the state jurisdiction. As changes are made,
29 there must be measures, including residual adjustment of any State USF, to ensure that
30 consumers in the higher cost to serve and rural areas of Tennessee continue to have
31 access to quality telecommunication services at affordable rates.

32 Q: ARE THERE PROCEEDINGS PENDING IN THE INTERSTATE JURISDICTION
33 WHICH WILL AFFECT THE PLAN IN TENNESSEE OVER TIME ?

34 A: Yes. There are: (1) potential changes in the interstate access charge plan under
35 consideration by the FCC; (2) modifications to the jurisdictional separation of costs are
36 under evaluation by the Federal-State Joint Board; (3) the Rural Task Force organized by
37 the Joint Board and the FCC has recently forwarded its recommendations with respect to
38 the federal rural USF for which further evaluation is now underway; and (4) the terms and
39 conditions under which LECs in competition with each other will interconnect are

undergoing continuous reevaluation.

THRESHOLD ISSUE 1. a. -- IS A UNIVERSAL SERVICE FUND NEEDED AT THIS TIME FOR AREAS SERVED BY RURAL CARRIERS ?

Q: HOW ARE CHANGES IN OVERALL COST RECOVERY BY RURAL LECs RELATED TO A STATE UNIVERSAL SERVICE PLAN ?

A: As the industry undergoes a restructuring of rates and relative network cost recovery from the available sources, a State USF will become a necessary component of the overall cost recovery plan for rural, higher cost LECs. If changes in the established cost recovery mechanisms were to occur (as is likely in the foreseeable future) in the absence of a State USF to address high cost recovery, there would be a detrimental impact on rates and the remaining network cost recovery mechanisms. It is for these reasons that the Coalition has recommended that the TRA establish a State USF on an expedited basis for application to the Rural Telephone Companies. The Plan framework proposed by the Coalition members will address likely shifts in cost recovery in a straightforward manner.

Q: WHAT IS THE RELATIONSHIP OF ACCESS CHARGES TO OVERALL COST RECOVERY ?

A: The Coalition's Plan envisions intrastate access charge rate levels moving to lower levels over a transition period. Coalition Comments at 21. As the TRA is aware, BellSouth would like to move forward with changes in the intraLATA plan with the Coalition members. *Id.* at 14-27. Both potential events will cause a dislocation in overall cost recovery for the Coalition members.

Q: WHAT ARE THE POLICY CONSIDERATIONS AS CHANGES OCCUR IN ACCESS CHARGE RATE LEVELS ?

A: The fundamental issue here involves an examination of what the relative level of network cost recovery should be between basic service charges that telecommunications customers pay and the long distance charges that toll users pay for making long distance calls across the State. The latter prices are dependent on the level of access charges. As changes occur, network cost recovery must be shifted to new sources such as the State USF.

A properly balanced approach among these available cost recovery sources will yield a predictable and reasonable rate result for rural customers and a regulatory environment within which rural LECs can continue to build and operate quality networks.

As changes will likely occur in the telecommunications marketplace in Tennessee, it is incumbent on the TRA to provide a stable and predictable plan with regard to rate design and cost recovery for the rural customers of the Coalition members. The Coalition

1 members are currently the critical providers of Universal Service which this Commission
2 has recognized by its designation of these carriers as Eligible Telecommunications
3 Carriers ("ETCs"). The revenues that the Coalition members have historically derived
4 from their participation in the provision of access for intrastate toll calling has been an
5 integral component of cost recovery that has enabled these companies to provide quality
6 networks and services in the more rural parts of the State at reasonable and generally
7 comparable rates.

8 Proposals for extreme or abrupt changes in access charge levels must be avoided.
9 Accordingly, the Coalition's message here is that the TRA should seek an overall
10 reasonable relative recovery among the various sources in the State. The Commission
11 should properly balance the cost recovery of telecommunications networks in Tennessee
12 among the three sources which will be affected in this proceeding: (1) basic local
13 exchange service rates; (2) LECs' access charges; and (3) a newly formed State USF.

14 The Coalition wants to assure that any changes in access rates do not occur at the expense
15 of overall rational basic rate design and levels. The overall public interest will be best
16 served if a proper balance is maintained among these sources -- a balance that will
17 achieve the universal service goals under a viable and sustainable plan. The Coalition's
18 Plan would preserve a comprehensive and coordinated relative cost recovery among these
19 sources.

20 Telecommunications is in the midst of potentially turbulent events. Accordingly, a
21 coordinated and complementary set of provisions will be required to ensure a proper
22 public interest result. The Coalition's Plan will serve the objectives by moving access
23 charges to lower levels while still maintaining a measured and coordinated approach that
24 will avoid disruption to rural customers and rates.

25 Q: IS A UNIVERSAL SERVICE FUND NEEDED AT THIS TIME FOR AREAS
26 SERVED BY RURAL CARRIERS ?

27 A: Yes. As explained above, there are cost recovery shifts and interstate changes that will
28 affect intrastate cost recovery and rates. A State USF will be required to address these
29 changes.

PRELIMINARY ISSUES 1 a. and b. -- WHICH SERVICES SHOULD BE SUPPORTED BY AN INTRASTATE RURAL UNIVERSAL SERVICE SYSTEM ? SHOULD ADVANCED TELECOMMUNICATIONS SERVICES BE SUPPORTED BY AN INTRASTATE RURAL UNIVERSAL SERVICE FUND ?

Q: WHICH SERVICES SHOULD BE SUPPORTED BY A STATE RURAL UNIVERSAL SERVICE FUND ?

A: The Coalition supports an evolving approach to determine the network services that universal service policies should support. The FCC's approach contemplates periodic review and reevaluation of the services outlined in Section 54.101 of the FCC's rules. The TRA should pursue a similarly flexible approach. For the initial approach, however, the Coalition supports the use of the core set of services that the FCC and the Federal-State Joint Board has developed in CC Docket 96-45. Congress and the FCC have already established that the cost of networks built and operated to provide this set of services will be supported by the USF. The FCC's list of services are those that must be provided by a LEC in order to be eligible to be designated as an ETC.

As the TRA is aware, Congress gave to the states additional authority to address universal service objectives beyond the level that the FCC policies will address. In Section 254(f), Congress provided that states can adopt regulations not inconsistent with the FCC's rules to preserve and advance Universal Service. These regulations can accommodate additional definitions and standards to preserve and advance Universal Service within a state. Therefore, the TRA can address other universal service principles under this authority. The Act only requires that state policy lead to "specific, predictable, and sufficient mechanisms" and that the additional state plan "not rely on or burden Federal universal service support mechanisms." It is not likely that additional, laudable, universal service goals would conflict with these already related objectives. The TRA and the industry can examine and consider other goals in Tennessee as the plan proceeds.

Q: WHAT IS THE PUBLIC INTEREST OBJECTIVE OF HIGH COST UNIVERSAL SERVICE SUPPORT PLANS ?

A: The purposes for universal service support are embodied in the list of principles that Congress adopted with the 1996 Act. Once a carrier is designated as an ETC and receives support from the federal USF, that support is intended to foster the achievement of the intended universal service objectives. The most relevant objectives include:

(1) Quality and rates. -- Quality services should be available at just, reasonable, and affordable rates.

(2) Access to advanced services. -- Access to advanced telecommunications and information services should be provided in all regions of the Nation.

1 (3) Access in rural and high cost areas. -- Consumers in all regions of the Nation,
2 including low-income consumers and those in rural, insular, and high cost areas, should
3 have access to telecommunications and information services, including interexchange
4 services and advanced telecommunications and information services, that are reasonably
5 comparable to those services provided in urban areas and that are available at rates that
6 are reasonably comparable to rates charged for similar services in urban areas.

7

8 (5) Specific and predictable support mechanisms. -- There should be specific,
9 predictable and sufficient Federal and State mechanisms to preserve and advance
10 universal service.

11 47 U.S.C. § 254(b).

12 It is my position that the objectives embodied in the Tennessee Universal Service
13 statutory provisions are essentially identical to that which Congress set forth in the 1996
14 Act.

15 Q: IS THE DEVELOPMENT OF UBIQUITOUS, QUALITY NETWORKS WITH
16 ADVANCED SERVICES CAPABILITIES DEPENDENT ON UNIVERSAL SERVICE
17 POLICIES AND SUPPORT ?

18 A: Yes, particularly for rural, higher cost areas. State and federal USF is a component of
19 cost recovery that affects the ability of carriers to build, maintain, and improve networks
20 and their ability to introduce advanced services.

21 The TRA must confront the inescapable dilemma: (1) carriers require network cost
22 recovery in order to invest in networks; (2) cost recovery in high cost rural areas depends
23 on universal service support mechanisms as a key component of that cost recovery; and
24 (3) the commitment of carriers to build ubiquitous networks which will support advanced
25 services is dependent on overall cost recovery.

26 If sufficient levels of high cost support were not available, the current "carrier-of-last-
27 resort" carriers would not be able to continue to commit, at the existing level that has
28 resulted in the achievement of universal service throughout Tennessee, the capital to
29 provide quality, advancing telecommunications services. Lower levels of available
30 network cost recovery will translate into an adjusted level of ongoing capital commitment
31 to what could be revenue strained markets. Faced with uncertain and divided revenue
32 sources, including insufficient high cost support, rural LECs would be forced to
33 reevaluate investment plans, and these LECs would be forced either to scale back, to
34 delay, or to cancel projects. In addition to discouraging network investment, inadequate
35 high cost recovery sources will put greater pressure on rural carriers to raise service rates.
36 In the rural areas of Tennessee, changes in access charges and other mechanisms would
37 diminish the opportunity for the Coalition members to recover infrastructure investment,

1 and thereby discourage the advancement of universal service in the absence of the
2 implementation of new mechanisms such as those proposed by the Coalition.

3 Q: DO NETWORK INVESTMENT COMMITMENTS AND COST RECOVERY
4 EXPECTATIONS APPLY TO THE DEVELOPMENT OF ADVANCED SERVICES?

5 A: Yes. A review of the FCC's recent initiatives and national network deployment already
6 underway suggest that the future of ubiquitous availability of broadband and advanced
7 services lies with evolving wireline networks such as those operated by the Coalition
8 members. The FCC has conducted proceedings with respect to deployment of advanced
9 telecommunications capability to all users to examine possible steps to accelerate this
10 deployment. High cost universal service support will undoubtedly be essential in the
11 promotion of broadband networks and advanced services in rural areas. The wireline
12 networks of the Coalition members hold the greatest promise of broadband, advanced
13 services delivery. This has been recognized by FCC's "strategy" for rural access to high-
14 speed Internet services. See "News: FCC Chairman Kennard Meets With Senators; Maps
15 Out Strategy For Rural Access To High-Speed Internet Services" released by the FCC on
16 June 10, 1999.

17 The FCC also appears to recognize the relation between investment incentives and cost
18 recovery expectations. For example, in a decision released in September, 1999, the FCC
19 decided not to impose network unbundling requirements for packet switching and digital
20 subscriber line facilities.

21 Q: SHOULD ADVANCED TELECOMMUNICATIONS SERVICES BE SUPPORTED BY
22 AN INTRASTATE RURAL UNIVERSAL SERVICE FUND ?

23 A: Yes. The objectives that Congress set forth in TA-96 include the promotion of advanced
24 services in rural areas. The FCC has recognized this to be a goal of its policies.
25 Investment in networks that will be capable of supporting advanced services will be
26 dependent on high cost support provided by state and federal universal service funding.

27 Q: IS HIGH COST SUPPORT DIRECTED TO "SERVICES ?"

28 A: In reality, no. The cost of Universal Service is in the cost of the total network over which
29 services are provided. The cost of a universal service network includes the entire cost of
30 the network to provide the services. Providing cost support to networks that are capable
31 of providing advanced services is an important public interest objective.

32 Q: SHOULD STATE USE HIGH COST SUPPORT BE DIRECTED TO SPECIFIC
33 CUSTOMER GROUPS ?

34 A: No, not with respect to the network cost recovery universal service mechanisms which I
35 am addressing. Denying network high cost support on the arbitrary basis of customer
36 class distinctions would be counter-productive and inconsistent with total network cost

1 recovery objectives. (Other concerns with respect to specific customer groups are
2 addressed through specific programs such as the Lifeline and Link-Up plans.)

3 There may be suggestions that USF disbursements should somehow be limited to
4 “residential lines.” The Coalition cautions against such arbitrary and counter-productive
5 limitations. The cost of providing universal service, carrier-of-last-resort facilities
6 networks does not end with one class of customer to the exclusion of other classes of
7 customers or the development of quality and advanced services. Instead, LECs construct
8 their networks to provide services to all users and for all services in their service area
9 over the foreseeable future for the plant investment. Cost recovery support is directed to
10 networks, not customers. Accordingly, universal service cost recovery in high cost areas
11 cannot arbitrarily be divided between customers “qualifying” for Universal Service and
12 those customers that do not. To do so would be inconsistent with the letter and the spirit
13 of § 254 of the 1996 Act.

14 Moreover, denying universal service funding based on an arbitrary segregation of LECs'
15 customers or lines will be counter-productive to the goals of the universal service plan.
16 Current universal service high loop cost recovery under the current federal USF plan for
17 the Coalition members is based on the entire cost of the local distribution network.

18 If universal service funding were, for example, denied for business customers, rates
19 would be much higher in high cost areas for the business customers. Higher rates would
20 have the counter-productive effect of lowering demand among the classes of customers
21 for which support is denied. This, in turn, would lead to higher per-customer network
22 costs and increase the high-cost recovery requirements for rural companies. In addition,
23 the higher rates would discourage economic development in rural areas by business.

24 Therefore, denying universal service support on the arbitrary basis of customer classes
25 will lead to higher prices for services to those customer classes denied, less demand for
26 services by those customer classes, lower relative levels of revenues because of the lower
27 demand, and higher universal service support requirements to cover the cost of the
28 network.

29 TA-96 not only requires that rates be affordable, but that rates also be comparable and
30 reasonable. If universal service cost recovery is denied to certain classes of customers,
31 the costs that would have been supported by universal service funding would instead have
32 to be recovered from the rates charged to LEC customers. As a result of this additional
33 cost recovery burden, rates in high cost areas for the denied class of customers will
34 neither be comparable to rates charged in lower cost areas, nor reasonable.

PRELIMINARY ISSUE 2 a. -- IS A CARRIER OF LAST RESORT DESIGNATION NECESSARY WHEN IMPLEMENTING A RURAL UNIVERSAL SERVICE FUND ? IF SO, HOW SHOULD CARRIERS OF LAST RESORT BE DETERMINED ?

Q: WHAT SHOULD THE ELIGIBILITY REQUIREMENTS BE FOR CARRIERS TO QUALIFY FOR STATE USF IN RURAL AREAS ?

A: Eligible Telecommunications Carriers ("ETCs") should be eligible for support. The TRA should designate ETCs consistent with the federal statute. Moreover, ETC designation policy should promote continued carrier-of-last-resort facilities networks. Only those carriers that serve as carrier-of-last-resort providers should receive support.

Q: SHOULD A CARRIER BE REQUIRED TO ASSUME THE STATUS OF CARRIER OF LAST RESORT IN A SERVICE AREA AS A PREREQUISITE FOR STATE USF SUPPORT ?

A: Yes. The straightforward answer is that only those telecommunications service providers that truly serve as the carrier of last resort in challenging service areas should receive universal service high cost recovery support. In the context of the establishment of a State USF, a carrier should be required to provide service ubiquitously to all as a prerequisite to be eligible to receive USF support

Q: WHAT IS THE RELATIONSHIP BETWEEN ETC DESIGNATION AND UNIVERSAL SERVICE OBJECTIVES ?

A: Congress adopted explicit public interest objectives with respect to ETC designations intended to serve the objectives and principles of Universal Service. Once a carrier is designated as an ETC and will receive support, the ETC "shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." *See* 47 U.S.C. § 254(e). Section 214(e)(1) of the Act explicitly states that designation of an ETC is "in accordance with section 254" universal service principles, and Section 254 states that "[a]ny such support should be explicit and sufficient to achieve the purposes of this [Universal Service] section." Congress necessarily intended that Section 214 be directly related to the objectives outlined in Section 254.

Congress recognized the greater potential danger to customers and potential counter-productive effects presented by the possibility of more than one ETC in a rural LEC area. Therefore, Congress adopted an additional provision beyond that which applies to non-rural LEC areas. This additional consideration requires that the designation of an additional ETC within a rural LEC area can occur only after an affirmative determination "that the designation is in the public interest." *See* 47 U.S.C. § 214(e)(2).

Q: HOW SHOULD ETC DESIGNATION PROMOTE CONTINUED CARRIER OF LAST RESORT FACILITIES NETWORKS.

1 A: Requirements established for the purpose of determining carrier eligibility for universal
2 service high cost recovery support should be tailored to achieve the universal service
3 goals. Eligibility criteria must distinguish those carriers actually committed to the
4 provision of ubiquitous service across their service areas from carriers only committed to
5 the better-than-average target customers and areas. Eligibility criteria must also
6 distinguish carriers assuming long-term network investment commitment from carriers
7 that pursue short-term, limited commitment competitive opportunities.

8 For a “carrier of last resort” (which the Coalition members currently are), the network
9 costs for which sufficient USF cost recovery must support are determined in the first
10 place based on the cost of a network to serve all customers with all of the services
11 offered. A last-resort carrier’s analysis involves life cycle engineering of plant designs
12 and population projections to arrive at the carrier-of-last-resort network. If the carrier
13 expects to be capable of providing service to all in the next several years, it has to build
14 its network based upon the total projection. A carrier commits to carrier of last resort for
15 the length of time it will take to recover the cost of this network. This commitment
16 necessarily depends on reasonably assured cost recovery over this period of time. The
17 ultimate cost recovery climate imposed by policymakers, including state and federal high
18 cost support mechanisms, will largely determine the network capital deployment
19 decisions of carriers.

20 **PRELIMINARY ISSUES 3 a. and b. -- IS A RURAL UNIVERSAL SERVICE**
21 **FUND NECESSARY TO ENSURE AFFORDABILITY OF RATES IN**
22 **RURAL AREAS ? HOW SHOULD AFFORDABILITY OF RATES IN**
23 **RURAL AREAS BE DETERMINED ?**

24 Q: IS A STATE USF FOR RURAL AREAS NECESSARY TO ADDRESS
25 AFFORDABILITY OF RATES FOR RURAL USERS ?

26 A: Yes. The Coalition members cannot maintain the provision of Universal Service
27 including maintaining affordable rates in the absence of adequate cost recovery to support
28 their networks. The cost recovery sources of the Coalition members are likely to be
29 affected negatively in the coming months as a variety of actions converge on their
30 operations. Therefore, a State USF will be necessary to maintain affordable rates. As
31 changes occur, a State USF directed to rural telephone companies will be required to
32 ensure that consumers in the higher cost to serve and rural areas of Tennessee continue to
33 have access to quality telecommunication services at affordable rates.

34 Q: IS AFFORDABILITY THE ONLY CONSIDERATION ?

35 A: No. Under the 1996 Act, universal service principles not only include availability of
36 quality services at affordable rates but include other provisions which require that rates be
37 just, reasonable and comparable. Specifically, the Act includes the objective that access

1 to interexchange and advanced telecommunications and information services, comparable
2 to the services available in urban areas, be available to all consumers in all regions,
3 including rural and high cost areas, at rates that are reasonably comparable to those of
4 services provided in urban areas. See 47 U.S.C. §254(b)(1)-(3).

5 Therefore, in addition to affordability, rates must also be just, reasonable, and
6 comparable. Where otherwise reasonable and comparable rates would not be affordable
7 by low-income users, affordability is addressed by the lifeline and link-up plans.

8 The achievement of comparable rates presents a greater support challenge in high cost
9 areas than does affordability. For example, many customers may be able to “afford” \$100
10 a month rate for basic local service, but \$100 a month would neither be reasonable nor
11 comparable to rates in urban areas.

12 The costs of networks in urban, high growth, low per-unit cost areas will determine the
13 competitive price of services in those urban areas. The potential disparity between urban
14 and rural rates could widen as incumbents are forced to deaverage their urban rates to
15 meet the selective market price of new entrant competitors. The urban prices will
16 establish the standard to which comparable rates will be measured.

17 Rate comparisons will require adjustments to recognize differences in the value of
18 services actually received. There is an effective disparity in rates between urban areas
19 and rural areas by virtue of fundamental rate structure and calling scope differences.
20 While absolute rate levels may be comparable, the effective levels are much higher in
21 rural areas. For example, a flat rate of \$15.00 a month for unlimited calling to perhaps a
22 hundred thousand subscribers in an urban area is not comparable to a flat rate of \$15.00
23 for unlimited calling to only a few hundred customers in a rural area. While smaller and
24 more rural companies sometimes have lower basic rate levels than the larger more urban
25 companies, the subscribers of small, rural telephone companies must supplement local,
26 flat-rated calling with toll calling to achieve connectivity to a similar communications’
27 community of interest.

28 Q: HOW SHOULD AFFORDABILITY IN RATES IN RURAL AREAS BE
29 DETERMINED ?

30 A: There are no specific standards to judge affordability exactly. Regardless, if the plan
31 sufficiently addresses comparability, then rates can be assumed to be affordable. The
32 FCC in developing the federal plan has presumed that existing rates are affordable and
33 will monitor “affordability” through subscribership levels and by working collegially
34 with the states on this issue. The Coalition’s Plan also presumes that current rates,
35 including a comparison to a benchmark rate, are affordable. The Coalition’s Plan,
36 therefore, inherently addresses affordability by assuring that rates remain affordable.

37 The TRA can examine, on a periodic basis, subscribership levels and any changes in
38 subscribership levels that would indicate changes in affordability of rates. This ongoing

1 examination should be used to reveal any detrimental effects that may arise from the
2 universal service changes arising from the federal and State plans.

3 **PRELIMINARY ISSUES 4 a. and b. -- HOW SHOULD IMPLICIT AND**
4 **EXPLICIT SUBSIDIES IN THE CURRENT RATES OF RURAL**
5 **PROVIDERS BE DETERMINED ? IS THERE A STATUTORY**
6 **REQUIREMENT OR NEED TO REMOVE IMPLICIT SUBSIDIES FROM**
7 **RATE OF RURAL PROVIDERS ?**

8 Q: IS IT NECESSARY TO IDENTIFY "SUBSIDIES" IN THIS PROCEEDING ?

9 A: No. The term "subsidy" must be placed in the proper context. There is no definitive
10 method to determine precisely whether one set of services "subsidize" other sets or to
11 determine the absolute amount of subsidization because there is no definitive method to
12 determine the true cost of a specific service. While theorists provide an array of
13 economic analyses in an effort to identify what is or is not an "explicit" or "implicit"
14 "subsidy," this type of inquiry is not necessary and could very well lead, based on
15 counter-productive theory, to the dismantling of beneficial and desirable socio-economic
16 rate designs that ensure Universal Service. Most of the economic theory arguments are
17 based on the false premise that the basic service customer should bear all of the non-
18 traffic sensitive network costs. The application of this theory would result in low access
19 charges for interexchange carriers and inordinately high basic service rates for rural
20 customers. This theoretical approach also would allow for the free use of terminating
21 facilities by toll users. The result of the application of this economic argument is
22 inconsistent with the universal service principles in § 254 of the 1996 Act. The Plan set
23 forth by the Coalition would avoid an unnecessary and potentially counter-productive
24 theoretical evaluation of "subsidies."

25 In any event, resources need not be diverted to a determination of "incremental" and
26 "stand-alone" costs of individual services in an effort to identify "subsidies." The results
27 of such determinations would be necessarily theoretical, arbitrary, and subject to extreme
28 dispute among experts and policymakers. Moreover, the range between incremental cost
29 on the low end and stand-alone cost on the upper end would be very large. The TRA
30 would still be forced to use its policy making judgement within the wide range of cost
31 limits.

32 Q: CAN THE AMOUNT OF "SUBSIDY" EMBEDDED IN SPECIFIC SERVICE RATES
33 BE SPECIFICALLY DETERMINED ?

34 A: No. The FCC has concluded that "it is difficult, if not impossible, to approximate the
35 actual portion of such costs for which each product or service is responsible." *See Order*,
36 In the Matter of Section 254(k) of the Communications Act of 1934, as amended, FCC
37 97-163, released May 8, 1997, at para. 8 (footnote omitted).

1 It is conceptually impossible to determine the extent of "implicit" subsidy on the basis of
2 any objective quantification of costs. The Preliminary Issue question set forth above
3 seems to suggest that there should be a determination of the extent to which current
4 intrastate access charges may contain "explicit or implicit subsidies." Of course, the fact
5 is that the same telecommunications network is used, and operating expenses are
6 incurred, for all services including access and local basic services.

7 Implicit subsidies exist only in the subjective sense based on one's view as to whether
8 one set of rates should be lower than they are today. Even if one were to presume that
9 some hypothetical level of access charges from which "implicit subsidies" have been
10 "removed" represents the optimum result for society, there is unfortunately no non-
11 arbitrary way to justify the answer objectively.

12 Q: WHY IS IT IMPOSSIBLE TO DETERMINE OBJECTIVELY THE ACTUAL COST
13 OF SPECIFIC SERVICES ?

14 A: It is impossible to determine the cost of specific services because telecommunications
15 networks are characterized by enormous amounts of costs that are joint and common with
16 respect to all services or groups of services.

17 The FCC concluded that it could not reliably calculate the "economic cost" of interstate
18 access services. In its own words, the FCC admitted that it understands that an economic
19 cost determination would be difficult, theoretical and subjective. The FCC discussed the
20 concepts of economic costs with respect to joint and common costs and the relevance to
21 the determination of service and network element costs in its August 1996 Local
22 Competition Interconnection Order (at para. 676) :

23 Certain types of costs arise from the production of multiple products or services.
24 We use the term "joint costs" to refer to costs incurred when two or more outputs
25 are produced in fixed proportion by the same production process (*i.e.*, when one
26 product is produced, a second product is generated by the same production
27 process at no additional cost). The term "common costs" refers to costs that are
28 incurred in connection with the production of multiple products or services, and
29 remains unchanged as the relative proportion of those products or services varies
30 (*e.g.*, the salaries of corporate managers). Such costs may be common to all
31 services provided by the firm or common to only a subset of those services or
32 elements. If a cost is common with respect to a subset of services or elements, for
33 example, a firm avoids that cost only by not providing each and every service or
34 element in the subset.

35 In defending its actions with respect to interstate access charge rate changes, the FCC
36 maintained that its decision not to embark on a determination of cost and implicit subsidy
37 was "supported by the long recognized regulatory problems associated with the allocation
38 of common costs [to services] that are not as prevalent in a determination of the economic
39 costs of unbundled network elements." (*See* Decision of the U.S. Court of Appeals for
40 the 8th Circuit, No. 97-2618, released on January 15, 1998, at p. 48.) Even more striking,

1 the Court cited (at page 49 of the decision) the FCC's example regarding local loop costs:

2 . . . the local loop is used to provide virtually all telephone services, but, in setting
3 rates for the various services, regulations must allocate a portion of the common
4 line loop cost to each individual service that uses the loop.

5 Q: HOW SHOULD IMPLICIT AND EXPLICIT SUBSIDIES IN THE CURRENT RATES
6 OF RURAL PROVIDERS BE DETERMINED ?

7 A: As explained above, there cannot be an objective evaluation of these theoretical subsidies.
8 Moreover, a resolution of a State USF does not require specific evaluation of these issues.

9 Policymakers must separate the questions of what represents reasonable, relative cost
10 recovery among different services and what is the absolute, objective amount of
11 "subsidy" that may be currently contained in specific intrastate rates. In a regulated
12 environment, the regulators cannot avoid the ultimate responsibility of determining the
13 allocation of joint and common costs to individual regulated services in order to sustain
14 reasonable rates in accordance with the overall public interest. In a competitive
15 environment, competitors make pricing decisions on a market driven basis to determine
16 how much of the joint and common costs will be recovered from an individual service or
17 product. Obviously, no one possesses the wisdom to determine beforehand, or to
18 determine in the absence of actual market observations, how the market demand and
19 supply would determine prices and hence how competitive pricing decisions would be
20 made.

21 Q: IS THERE A STATUTORY REQUIREMENT OR NEED TO REMOVE IMPLICIT
22 SUBSIDIES FROM RATES OF RURAL PROVIDERS ?

23 A: As I have explained above, there is no ability to identify the absolute levels of so-called
24 "implicit" subsidies contained in current rates. Both the FCC and the courts have
25 reviewed this question and have concluded that it is not possible to make such an absolute
26 determination. The FCC has gone forward with changes in interstate access rates and has
27 specifically avoided any objective evaluation of what the economic costs of access are.
28 The price-cap carriers have lowered their interstate access rates to levels according to an
29 arbitrary and subjective choice.

30 To avoid this dilemma, the Coalition has proposed a transition plan for intrastate access
31 rate levels that would eventually lead to rates that parallel interstate access rate levels.
32 The Plan represents a prudent and efficient course to move forward with changes which
33 most parties recognize as the right direction, without burdening the process with an
34 impossible evaluation.

35 There is no compelling need to focus attention non-productively on a theoretical
36 examination of subsidies. Instead, the emphasis should be placed on the implementation
37 of a State USF and the results of the overall universal service plan. These results can be

1 judged in terms of whether reasonable, comparable and affordable rates are maintained
2 and whether an overall regulatory plan continues to provide incentives for carriers to
3 upgrade networks and develop advanced network services. The Act sets forth a list of
4 universal service objectives and principles which should guide the evaluation of policy.
5 As the realities of the changing marketplace place pressure on rate designs that have, in
6 the past, been the tools to address reasonable and comparable rates, the TRA will need to
7 address shifting cost recovery quickly so as not to jeopardize the success already
8 achieved. If successful policies are established and maintained, then the implicit and
9 explicit subsidies will have been appropriately addressed. The objectives must be
10 achieved in the context of real-world costs and operations.

11 **PRELIMINARY ISSUE 5 -- ARE ANY CHANGES IN STATE LAWS OR**
12 **TRA RULES NEEDED TO IMPLEMENT A RURAL UNIVERSAL SERVICE**
13 **FUND ?**

14 Q: ARE CHANGES NEEDED IN STATE STATUTES TO IMPLEMENT A STATE USF ?

15 A: As I have pointed out previously, the Tennessee statute contains flexibility such as in the
16 definition of services to be support by any universal service plan including any "other
17 services required by state or federal statute." The statute's provision to comply with
18 federal requirements would seem to provide the TRA with a degree of flexibility that may
19 avoid some, if not all, potential changes in the Tennessee statute that could be viewed as
20 necessary to coordinate with ordered changes in this docket. *See* Tenn. Code Ann. § 65-
21 5-208(a)

22
23 Accordingly, the Coalition does not believe at this time that there are any changes to
24 State law needed to move forward with this proceeding. As this proceeding continues,
25 however, the resolution of issues could conceivably require some changes in State law. If
26 such a requirement arises, the drafting of any proposed changes should be undertaken
27 based on the specific issue requiring action. Counsel to the Coalition are of the opinion
28 that no statutory change is required to implement the proposal set forth by the Coalition.

29 Q: WILL CHANGES IN THE TRA'S RULES BE NEEDED TO IMPLEMENT A STATE
30 USF ?

31 A: Changes in the TRA's regulations are likely to be required to implement the ultimate
32 resolution of this proceeding.

33 Q: HOW CAN CONSISTENCY WITH THE FEDERAL UNIVERSAL SERVICE
34 PROVISIONS BE ENSURED ?

35 A: There are several objectives and requirements of the federal Act which will require
36 reconciliation with a state plan.

1 The "sufficiency" provision of the federal statute, in application, should be viewed as a
2 results-dependent requirement. If a universal service support program achieves the
3 necessary objectives, the plan satisfies the "sufficient" criterion. In contrast, one that
4 does not fully address the objectives of Universal Service or does not yield the expected
5 results cannot be deemed "sufficient."

6 **PRELIMINARY ISSUE 6 a. -- WHAT COST MODEL/METHOD AND**
7 **METHODOLOGY SHOULD BE ADOPTED TO CALCULATE NEEDED**
8 **UNIVERSAL SERVICE SUPPORT IN RURAL AREAS ? (i.e., FORWARD**
9 **LOOKING, TELRIC, EMBEDDED, ETC.)**

10 Q: HOW SHOULD NETWORK COSTS, TO BE SUPPORTED BY A STATE USF FOR
11 RURAL CARRIERS, BE DETERMINED ?

12 A: For the Rural Telephone Company members of the Coalition, the federal universal
13 service plan bases cost support on reported accounting costs -- what most refer to as
14 "embedded" costs. Consistent with proposed Plan, the Coalition recommends that the
15 State process and plan for rural companies should continue to apply this approach.

16 Q: DOES THE COALITION PLAN REQUIRE AN EVALUATION OF COSTS USING
17 SOME COSTING METHOD ?

18 A: No. The Coalition's Plan is an expedient method to address revenue dislocations as well
19 as the ramifications of the BellSouth announced termination of the intrastate intraLATA
20 settlement arrangement currently in place. The objective of the plan is to maintain
21 reasonable and comparable rates during a rate redesign transition period. The Plan
22 purposefully avoids evaluation of cost models and other methodology.

23 Q: DOES THE FEDERAL PLAN FOR USF CONTEMPLATE COST MODELS ?

24 A: The interstate USF plan is still not resolved. In late September, the Rural Task Force
25 submitted its recommendation developed over more than two years. Its recommendation
26 includes analysis of the available cost models and an evaluation of the efficacies of the
27 models for use in rural service areas. Their recommendation concludes that the models
28 are not sufficiently useful for rural telephone company purposes. In any event, the Rural
29 Telephone Companies continue to use an embedded cost approach for the current
30 interstate USF plan.

31 At minimum, cost models should not be utilized initially in conjunction with the
32 implementation of the proposal set forth by the Coalition. The Coalition was very
33 mindful of the need to balance timely implementation of a new State USF mechanism
34 with the statutory requirements of sufficiency and predictability. The Coalition and I are
35 concerned about whether models will accurately estimate costs for rural carriers'

1 operations. Accordingly, consideration of models is both unnecessary and unwarranted
2 with respect to the implementation of the Coalition's Plan.

3 Notwithstanding the recommendation of the Rural Task Force, the plan of the FCC has
4 always been that models or estimates of costs would be applied to rural telephone
5 companies only if validation can be obtained that the results are accurate and will lead to
6 sufficient and reliable high cost universal service support consistent with the universal
7 service goals. With several years of development involving extensive industry resources,
8 the accuracy of the federal effort continues to be questioned.

9 Modeling costs across a diverse set of network characteristics and service areas is very
10 difficult and complex. The number of variables actually considered by engineers in
11 designing and constructing a network is large and beyond the scope of simple formulas
12 utilizing a limited number of readily available variable inputs. Short-cut or surrogate
13 variable inputs cannot adequately relate to reality.

14 Future consideration and use of models of cost could prove useful in the same way that
15 interstate "average schedules" provide an administratively less burdensome costing tool.
16 In my opinion, however, it will be most difficult to model costs for the highest cost areas
17 because these areas exhibit the most unique network cost characteristics and service
18 challenges. The unfortunate irony is that the rural areas that most likely require universal
19 service cost recovery support may also be the areas most likely not to conform to model
20 estimates of costs.

21 **PRELIMINARY ISSUE 6 b. -- SHOULD THE REVENUE BENCHMARK**
22 **APPROACH AS ADOPTED BY THE TRA FOR NON-RURAL PROVIDERS**
23 **BE USED FOR IDENTIFYING HIGH COST UNIVERSAL SERVICE**
24 **SUPPORT IN AREAS SERVED BY RURAL CARRIERS ?**

25 Q: WILL THE TRA NEED TO DEVELOP A REVENUE BENCHMARK FOR A RURAL
26 STATE USF ?

27 A: Adoption of the Coalition's Plan would include a benchmark approach that is comparable
28 to what has been applied to the non-rural companies. Because the Coalition Plan
29 incorporates the current, existing rate structure and establishes a State USF based on
30 access charge rate reductions, it would inherently result in recovery of some of the
31 Coalition members network costs through rates that are "benchmarked" to market
32 comparable levels.

33 The operation of the plan would result in the recovery of a portion of the cost of the
34 networks of the Coalition members through access charges that would be reduced over
35 time. Therefore, one cost recovery component would include access charges that would
36 transition to reasonable "benchmarked" industry levels.

1 The Plan also involves recovery of a portion of the costs of the networks of the Coalition
2 members through basic service rates. The Plan recognizes that some Coalition members
3 may not have local service rates that are comparable to industry benchmarks. The Plan
4 contemplates the establishment of a “transitional benchmark basic service rate” for
5 calculation and evaluation purposes. Coalition Comments at 20-21. As access charges
6 are reduced, and a shift of cost recovery to the State USF is implemented under the Plan,
7 the actual State USF support will be adjusted to reflect appropriate recovery of costs at
8 the transitional benchmark basic service rate level. In other words, if the LEC’s basic
9 rates are below what is considered a reasonable transitional benchmark basic service rate
10 level, the support from the State USF will be adjusted to reflect what the LEC would
11 receive if the transitional benchmark basic service rate were actually applied. *Id.*

12 To the extent that basic service rates are less than the transitional benchmark basic service
13 rate level, LECs would be allowed to raise their basic rates according to the transition
14 plan. However, no LEC would actually be required to raise their basic rates if it opted
15 not to do so. Regardless, the evaluation and comparison to the benchmark basic service
16 rate is applied for the purpose of calculating the necessary State USF support amount for
17 all participants.

18 Q: WHAT BENCHMARKS NEED TO BE DEVELOPED IN THIS PROCEEDING ?

19 A: The Coalition Plan necessarily involves the development of the proper transitional
20 benchmark basic service rates. The TRA can use this proceeding to examine and
21 determine what the proper benchmark basic rate and transition should be for the Plan.
22 The benchmark access charge rates will be determined generally by interstate rates.

23 **PRELIMINARY ISSUE 7 a. -- SHOULD WIRELESS-TO-WIRELESS**
24 **CALLS AND CALLS WITH WIRELESS TERMINATION BE INCLUDED**
25 **IN THE RURAL UNIVERSAL SERVICE FUND ?**

26 Q: SHOULD CALLS BETWEEN WIRELESS CARRIERS AND CALLS THAT
27 TERMINATE TO WIRELESS USERS BE ADDRESSED BY THE STATE USF PLAN
28 FOR RURAL AREAS ?

29 A: No. USF cost recovery support is not directed to carriers on the basis of “calls.” As I
30 have explained above, USF cost recovery support is directed to the recovery of the cost
31 of networks, regardless of the number or type of “calls.” Also, as I have explained above,
32 USF cost recovery support should be directed to carriers that have been designated as
33 ETCs. Accordingly, the preliminary Issues set forth above are either extraneous to this
34 proceeding or premature.

35 Q: HAVE WIRELESS CARRIERS BEEN DESIGNATED AS ETCs IN TENNESSEE ?

1 A: I am not aware of any commercial mobile radio service (“CMRS”) providers that have
2 been designated as ETCs in Tennessee. As a general matter, I do not support designation
3 of CMRS providers of mobile services as ETCs nor would I support providing USF
4 support dollars for CMRS networks which provide mobile services. This matter is
5 distinct from the issue of whether a wireless provider of fixed service should be
6 considered for ETC designation.

7 Q: ARE THERE SEPARATE ISSUES WITH RESPECT TO THE QUESTION OF
8 WHETHER MOBILE CARRIERS AND/OR CMRS PROVIDERS SHOULD BE
9 DESIGNATED AS ETCs ?

10 A: Yes. There is a long list of issues surrounding the questions of under what conditions, if
11 any, a CMRS provider should be designated as an ETC. It would appear that these issues
12 are well beyond the necessary scope of this proceeding, at this time. At the appropriate
13 time, I can provide extensive, additional testimony on the issues surrounding CMRS
14 providers, the regulatory treatment of CMRS providers seeking ETC status, and ETC
15 designation issues.

16 At this point, I would note that mobile services are beyond the scope of universal service,
17 and in any event, the current interstate USF plan is unworkable with respect to mobile
18 services and shared-spectrum wireless applications. A large number of issues
19 surrounding the potential treatment of CMRS providers in the context of the federal plan
20 remain before the FCC including whether the fixed service offerings of CMRS providers
21 should be subject to the same conditions and requirements applied to any other LEC. To
22 be designated as an ETC, all carriers must be subject to the same accountability
23 conditions as a prerequisite of ETC designation.

24 **THRESHOLD ISSUE 1 b. -- SHOULD THE CURRENT EARNINGS OF**
25 **THE RURAL CARRIER BE CONSIDERED WHEN DETERMINING THE**
26 **NEED AND/OR SIZE OF A UNIVERSAL SERVICE FUND ? IF SO, HOW ?**

27 Q: WHAT ROLE SHOULD EARNINGS EVALUATIONS PLAY IN THE
28 ESTABLISHMENT OF A STATE USF ?

29 A: There is an appropriate role for the consideration of earnings in the ongoing
30 administration of a State USF, but the TRA should take extra care to ensure that
31 arguments under the guise of “earnings” concerns are not utilized by parties to promote
32 their own self-interests and agendas at the expense of genuine universal service
33 considerations. The TRA can serve the public interest as a whole and fully control this
34 outcome by distinguishing the initial establishment and sizing of a State USF for rural
35 carriers from other ongoing regulatory administration issues.

36 The need for the establishment of the new universal service mechanism is clear and

1 immediate and should not be contingent on an individual company's earnings. The
2 Coalition Comments described the need to establish a reasonable rate design on a
3 transitional basis for both intrastate access and basic services offered by the rural carriers.
4 Changes in rate design will lead to revenue recovery dislocations in the absence of the
5 State USF mechanism proposed by the Coalition. The issues raised by BellSouth's
6 cancellation of intraLATA toll settlement agreements further exacerbates the situation.

7 The Coalition's Comments set forth a comprehensive conceptual proposal for
8 implementing rate design change together with the establishment of a fund that would
9 provide a new framework for the continued fostering of Universal Service throughout
10 Tennessee. The Coalition's Plan establishes a basis to move forward to establish this
11 initial framework in an administratively efficient manner that addresses both the
12 ramifications of the BellSouth unilateral termination of settlement agreements and the
13 existing universal service considerations; i.e., reasonable and comparable rates for basic
14 services and reasonable access rate levels that continue to promote availability of
15 statewide average toll rates.

16 Subsequent to the establishment of the State USF for rural carriers and the rate redesign
17 Plan as proposed by the Coalition, the Authority would be well advised to initiate
18 consideration of future fund size requirements. In the course of this future proceeding,
19 the Authority may consider a company's earnings needs in the context of the provision of
20 Universal Service.

21 The Coalition members have an unquestioned history of reinvesting a significant portion
22 of their earnings in infrastructure in Tennessee to improve the provision of service. As
23 technology rapidly evolves, the definition of Universal Service will likely also evolve. A
24 broader definition of Universal Service will entail increased technological investment by
25 carriers which will, in turn, inescapably produce pressures to increase basic service rates
26 or USF requirements. In addition to the impact of technological change, there are several
27 additional, but unmeasurable, changes that will impact in the near future both the
28 earnings of rural carriers and State USF requirements. These changes include
29 jurisdictional separations, interstate access charges, and interstate universal service. Each
30 of these matters is currently under consideration, but unresolved by the FCC. The
31 resolution of each of these issues will impact the earnings levels of rural carriers and the
32 State USF requirements that may be required to achieve universal service objectives in
33 Tennessee. Undoubtedly, there exists numerous additional concerns that the Authority
34 will also want to consider when it deliberates future rural carrier universal service fund
35 requirements.

36 Accordingly, on behalf of the Coalition members, I recommend that this matter be
37 undertaken separately and subsequent to the initial implementation of the State USF and
38 rate redesign Plan for two basic reasons. First, as I have briefly discussed, the matter of
39 future fund size requirements and rural carrier earnings is more complex than the current
40 matter before the TRA. Resolution of this matter in a manner that truly serves the public
41 interest will undoubtedly require a significant investment of time and effort to address
42 issues that are both quantitative and qualitative in nature. Second, these issues do not

1 have to be resolved immediately to bring overall benefit to the public. The
2 implementation of the State USF and rate redesign Plan for rural carriers as proposed by
3 the Coalition will result in public benefit, with no harm to any party, in a manner fully
4 consistent with the universal service principles set forth in both the state and federal
5 universal service statutory provisions.

6 **THRESHOLD ISSUES 2 a. and b. -- MUST A RURAL CARRIER WAIVE**
7 **ITS RURAL EXEMPTION PRIOR TO RECEIVING FUNDS FROM A**
8 **RURAL UNIVERSAL SERVICE FUND ? MUST A RURAL CARRIER**
9 **PROVIDE UNBUNDLED NETWORK ELEMENTS PRIOR TO RECEIVING**
10 **FUNDS FROM A RURAL UNIVERSAL SERVICE FUND ?**

11 Q: IS THE QUESTION OF WHICH SET OF INTERCONNECTION REQUIREMENTS
12 SHOULD APPLY TO SPECIFIC LOCAL EXCHANGE CARRIERS RELATED TO
13 THE UNIVERSAL SERVICE SUPPORT ISSUES IN THIS PROCEEDING ?

14 A: No. This threshold issue seems to be misplaced or based on a potential misunderstanding
15 of the Act, the interconnection requirements, the hierarchy of those requirements, and the
16 application of those requirements to Rural Telephone Companies. In fact, and as I will
17 elaborate below, the “rural exemption” is recognized by the 1996 Act, the FCC and the
18 Courts as a discrete mechanism to protect and foster Universal Service.

19 Q: MUST A RURAL CARRIER WAIVE ITS RURAL EXEMPTION PRIOR TO
20 RECEIVING FUNDS FROM A RURAL UNIVERSAL SERVICE FUND ?

21 A: No. There is no dependent relationship between the § 254 universal service provisions
22 (including the related § 214 ETC provisions) and the § 251 interconnection requirements.
23 The need for sufficient universal service support, and the receipt of that support, does not
24 depend on the status of the exemption.

25 Q: SHOULD A RURAL CARRIER BE REQUIRED TO PROVIDE UNBUNDLED
26 NETWORK ELEMENTS AS A CONDITION OF RECEIVING RURAL UNIVERSAL
27 SERVICE FUND SUPPORT ?

28 A: No. As explained below, unbundled network elements are simply one of the elements of
29 the Section 251(c) requirements for which the exemption applies.

30 Q: WHAT ARE THE SPECIFIC INTERCONNECTION REQUIREMENTS ?

31 A: Congress enacted the 1996 Act to promote the provision of advanced telecommunications
32 services to all Americans through competition in the telecommunications industry while,
33 at the same time, preserving and fostering Universal Service. The market intervention
34 provisions and carrier requirements that Congress adopted for this change are generally

described as interconnection requirements.

There are multiple sets of interconnection obligations, with differing levels of requirements, that apply to different groups of carriers.

Q: HOW DO THE DIFFERENT SETS OF REQUIREMENTS APPLY WITH RESPECT TO DIFFERENT TYPES OF CARRIERS ?

A: Section 251(a) prescribes a general duty for all telecommunications carriers (both incumbents and new entrants, as well as carriers other than LECs) to connect with each other either directly or indirectly and to operate networks according to technical and operational standards that allow all carriers to exchange traffic with each other. This basic requirement existed in other parts of the Act prior to the passage of the 1996 Act.

Section 251(b) imposes obligations on all LECs, both incumbents and new competitive providers of local exchange and exchange access services, (1) not to place restrictions on resale of service (to allow resale at retail rates); (2) to participate in number portability; (3) to participate in dialing parity; (4) to allow access to right of ways; and (5) to enter into arrangements with other competing carriers to exchange local service area traffic with each other according to specific terms and conditions. No LEC is initially exempt from the Section 251(b) requirements. However, small LECs (with less than 2 percent of the Nation's access lines) have been granted the opportunity under Section 251(f)(2) to request suspension and/or modification of the Section 251(b) requirements.

Congress also understood that in an industry that is as capital intensive as telecommunications with entrenched large incumbent carriers like the Bell operating companies, other measures were needed to allow new entrants a viable opportunity to enter large carrier markets. Therefore, Congress enacted Section 251(c), a third set of interconnection obligations which are the most onerous requirements that apply automatically to non-rural to incumbent LECs only. It was apparently believed that "handicapping" of incumbents was needed to allow the new entrants more of an opportunity to compete.

Section 251(c) imposes the most onerous requirements on some incumbent LECs: (1) to negotiate interconnection terms and conditions with potential competitors according to specific procedural requirements; (2) to provide to competitors specific network functions and elements according to specific unbundling requirements and other terms and conditions; (3) to allow competitors to collocate certain telecommunications equipment in an incumbent's facilities; and (4) to remove all restrictions on resale (to allow resale) and to allow other carriers to obtain services (for resale) from the incumbent at discounted prices.

Recognizing characteristic differences between the large incumbent LECs and rural telephone company incumbent LECs, Congress provided an immediate and initial exemption of the Section 251(c) requirements for rural telephone companies, i.e., the

1 rural exemption.

2 Q: WHY DOES A DISTINCTION EXIST IN THE ACT WITH RESPECT TO THE
3 IMPOSITION OF THE SECTION 251(c) INTERCONNECTION REQUIREMENTS?

4 A: The requirements of Section 251(c) are the most onerous requirements and are intended
5 to apply only to incumbent carriers that possess substantial market dominant advantages.
6 Congress recognized from the beginning that requirements that may be appropriate to
7 rebalance the market areas of the largest incumbent LECs are generally inappropriate to
8 apply to areas served by smaller LECs. Smaller rural telephone company LECs do not
9 exhibit the degree of market dominant dimensions that pose the same potential impact on
10 telecommunications markets as do larger LECs such as Bell companies.

11 Clearly, Section 251(c) requirements go beyond the statutory or regulatory inter-company
12 relationships expected of business entities in other competitive industries. Requiring any
13 incumbent LEC to operate under these disadvantageous, disparate requirements
14 automatically imposes an economic handicap that would not be imposed otherwise in a
15 competitive market. Requiring a rural telephone company to operate under these
16 conditions would impose relatively severe economic burdens. The more onerous
17 "market-balancing" requirements would impose disadvantages that would have a greater
18 negative impact on rural telephone companies than the larger incumbent LECs such as
19 Bell companies. Congress realized that such a negative impact could severely jeopardize
20 Universal Service for customers in rural and small company service territories, and
21 therefore included provisions to prevent such a result; i.e., exemption of the most onerous
22 Section 251(c) requirements. Moreover, in any market intervention effort to rebalance
23 the market, there is no purpose to be served by subjecting small and rural LECs to unjust
24 handicaps simply to promote and reward new entrants.

25 Q: DOES THE EXEMPTION FROM THE MOST ONEROUS SECTION 251(c)
26 INTERCONNECTION REQUIREMENTS FOR RURAL TELEPHONE COMPANIES
27 MEAN THAT THESE COMPANIES ARE EXEMPT FROM COMPETITION ?

28 A: No. It simply means that other carriers will interconnect under other interconnection
29 opportunities. Many competitive LECs compete without utilizing the Section 251(c)
30 interconnection.

31 Q: DOES THE EXEMPTION FROM THE MOST ONEROUS SECTION 251(c)
32 INTERCONNECTION REQUIREMENTS PREVENT OTHER CARRIERS FROM
33 PROVIDING TELECOMMUNICATIONS SERVICES IN THE AREAS SERVED BY
34 RURAL TELEPHONE COMPANIES THAT ARE EXEMPT ?

35 A: No. The exemption for Rural Telephone Companies does not have any effect on whether
36 other carriers can enter a specific service area to provide telecommunications services nor
37 does the exemption have any effect on the resolution of certification requests of other
38 carriers.

1 Q: DOES THE EXEMPTION FROM THE MOST ONEROUS SECTION 251(c)
2 INTERCONNECTION REQUIREMENTS PREVENT OTHER CARRIERS FROM
3 SEEKING ETC STATUS OR USF SUPPORT ?

4 A: No.

5 Q: HAS THE OPERATION OF THE EXEMPTION FROM THE MOST ONEROUS
6 SECTION 251(c) INTERCONNECTION REQUIREMENTS BEEN ADDRESSED BY
7 THE COURTS ?

8 A: Yes. The United States Court of Appeals for the Eighth Circuit issued a decision on July
9 18, 2000 which reflects on these issues ("8th Circuit Decision"). The 8th Circuit Court
10 recognized that the exemption and other provisions of Section 251(f) of the Act were
11 enacted by Congress to relieve smaller and more rural LECs of some burdensome
12 interconnection obligations otherwise imposed on incumbent LECs.

13 The 8th Circuit Court specifically clarified that the effect that interconnection
14 requirements would have on the achievement of universal service objectives is a relevant
15 factor that States should consider in evaluating interconnection requirements, beyond
16 other issues of economic burdens.

17 The Section 251(c) requirements are the most onerous and were intended to apply to the
18 larger incumbent LECs. Smaller LECs do not exhibit the degree of market dominance
19 that Bell companies do -- a dominance that the most onerous subset of Section 251(c)
20 interconnection requirements were obviously intended to address. The 8th Circuit Court
21 came to a similar conclusion. The Court concluded that, because Rural Telephone
22 Companies have less financial capacity than the larger incumbent LECs (such as Bell
23 companies), Congress declared that Rural Telephone Companies should remain exempt
24 from the most onerous subset of interconnection requirements (*i.e.*, Section 251(c)) unless
25 and until a finding can be made that the imposition of such requirements would not result
26 in economic harm to rural customers. 8th Circuit Decision at pp. 28-29. Moreover, in
27 light of the obvious effect of disparate requirements in a competitive world, the Court
28 concluded that "[t]here can be no doubt that it is an economic burden on an ILEC to
29 provide what Congress has directed it to provide to new competitors in . . . § 251(c)." 8th
30 Circuit Decision at p. 28.

31 It would be ironic and counter-productive to penalize rural LECs and their rural
32 customers unnecessarily with the most burdensome interconnection requirements. If the
33 Coalition members were to be subjected to the Section 251 (c) interconnection
34 requirements, the provision of Universal Service throughout their rural service areas
35 would be further burdened and threatened by producing pressures on the rates charged to
36 the general public and by imposing unnecessary economic harm on these small
37 companies. Such a result would be fundamentally contrary and adverse to the
38 achievement of the universal service goals. There is no public interest objective in
39 applying disadvantaging interconnection requirements to Rural Telephone Companies

1 that are already challenged by the rural service area network characteristics and other
2 asymmetrical regulation and policies associated with their incumbent and carrier of last
3 resort status.

4 Q: DO YOU HAVE ANY CONCLUDING RECOMMENDATIONS ?

5 A: Yes. I respectfully urge the Tennessee Regulatory Authority to consider and adopt the
6 Universal Service Rate Redesign Plan proposed by the Coalition. The Plan would
7 address the universal service objectives embodied in both federal and state policies. The
8 Plan addresses the immediate objectives in a useful and practical manner as the level of
9 access charges and changes in the relationship with BellSouth are encountered. More
10 importantly, the Plan would ensure continuation and predictability of reasonable and
11 comparable rates as changes are made in the coming years. The predictable cost recovery
12 that will result for the Coalition members will allow and encourage continuing
13 investment to promote advancing services as well as the maintenance of quality
14 telecommunications services to their rural customers.

15 The policy goal in this proceeding is to adopt a plan that will result in reasonable relative
16 cost recovery and comparable rates for telecommunications services for users in rural
17 service areas. The Coalition's Plan will accomplish this goal. As the industry continues
18 to find its way through the array of challenges and opportunities it faces, the Coalition's
19 Plan provides a reasonable and measured approach to address a multitude of objectives
20 that could otherwise produce continued conflict and results adverse to the public interest.
21 Accordingly, adoption of the Plan provides a prudent course in the context of the
22 uncertainty facing the Authority, rural consumers, and all other parties.

23 Q: DOES THIS CONCLUDE YOUR TESTIMONY ?

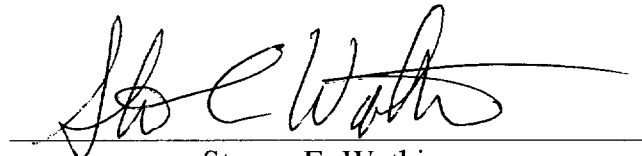
24 A: Yes.

DISTRICT OF COLUMBIA, ss:

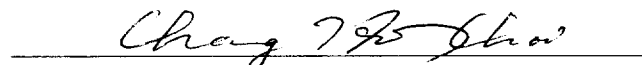
BEFORE ME, the undersigned authority, a Notary Public, duly commissioned and qualified in the District of Columbia, personally came and appeared Steven E. Watkins, who, being by me first duly sworn deposed and said that;

He is appearing as a witness on behalf of the Coalition of Small LECs and Cooperatives before the Tennessee Regulatory Authority and if present before the Authority and duly sworn, his testimony would be as set forth in the pre-filed testimony dated November 14, 2000, and filed in Docket No. 00-00523.

This 13th day of November, 2000.


Steven E. Watkins

Sworn to and subscribed before me this 13th day of November, 2000.


Notary Public, D.C.

My Commission Expires: CHANG HO CHOI, NOTARY PUBLIC
DISTRICT OF COLUMBIA
COMMISSION EXPIRES: 6/14/2004

SUMMARY OF WORK EXPERIENCE AND EDUCATION

Steven E. Watkins

November 2000

Q: Would you please describe your work experience.

A: My entire twenty-four year career has been devoted to service to those independent telecommunications firms that serve the small-town and rural areas of the United States.

Q: What is your current position ?

A: I have been a consultant with the firm of Kraskin, Lesse & Cosson, LLP since June, 1996. The firm concentrates its practice in providing professional services to small telecommunications carriers that provide service to rural and small-town America. My work at Kraskin, Lesse & Cosson, LLP, has involved assisting smaller, rural, independent local exchange carriers ("LECs") in their analysis of a number of regulatory and industry issues, many of which have recently arisen with the passage of the Telecommunications Act of 1996. I am involved in regulatory proceedings in several states on behalf of small LECs. These proceedings are examining the manner in which the Act should be implemented and other changes in those states. My involvement specifically focuses on those provisions most affecting smaller LECs and their rural customers, most notably including the preservation of Universal Service, and those requiring distinct considerations from the point of view of smaller telephone companies.

I have over the last four years instructed smaller, independent LECs on the specific details of the implementation of the Act including universal service mechanisms, interconnection requirements, and cost recovery.

Q: What did you do prior to joining Kraskin, Lesse & Cosson, LLP?

A: For 12 years, I held the position of Senior Industry Specialist with the Legal and Industry Division of the National Telephone Cooperative Association ("NTCA") in Washington, D.C.

Q: Please describe your responsibilities and work activities as NTCA's Senior Industry Specialist.

A: In that position, I represented approximately 500 small and rural local exchange carrier member companies on a wide array of regulatory, economic, and operational issues. My work involved research, analysis, formulation of policy, and expert advice to member companies on industry issues affecting small and rural telephone companies.

My association work involved extensive evaluation of regulatory policy, analysis of the effect of policy on smaller LECs and their rural customers, preparation of formal written pleadings in response to FCC rulemakings and other proceedings, weekly contributions to association publications, representation of the membership on a large number of industry committees and task forces, and liaison with other telecom associations, regulators, other government agencies, and other industry members. I also attended, participated in and presented seminars and workshops to the membership and other industry groups too numerous to list here.

Q: For those who may not be familiar with NTCA, what is the purpose of that Association?

A: NTCA is a national trade association of approximately 500 small, locally-owned and operated rural telecommunications providers dedicated to improving the quality of life in rural communities through advanced telecommunications. The Association advocates the interests of the membership before legislative, regulatory, judicial, and other organizations and industry bodies.

Q: Did you work in the telecommunications industry prior to your staff position with NTCA?

A: Yes, I worked for over eight years with the consulting firm of John Staurulakis, Inc., located in Seabrook, Maryland.

Q: And what were your duties with this consulting firm?

A: I reached a senior level position supervising a cost separations group providing an array of management and analytical services to over 150 independent telecommunications clients. The firm was primarily involved in the preparation of jurisdictional cost studies, access rate development, access and exchange tariffs, traffic analysis, property records, regulatory research and educational seminars.

Q: What other experience do you have in the telecommunications industry?

A: For over ten years, I served on the National Exchange Carrier Association's ("NECA") Industry Task Force charged with reviewing and making recommendations regarding the interstate average schedule cost settlements system. For about as many years, I served in a similar role on NECA's Universal Service Fund ("USF") industry task force.

Q: What is your educational background?

A: I graduated from Western Maryland College in 1974 with a Bachelor of Arts degree in physics. As previously stated, I have also attended industry seminars too numerous to list on a myriad of industry subjects over the years.

Q: Have you previously participated in any regulatory proceedings?

A: I estimate that I have prepared formal written pleadings for submission to the Federal Communications Commission on behalf of NTCA member and Kraskin, Lesse & Cosson client LECs in over two hundred proceedings. I have also contributed written comments in several state proceedings on behalf of Kraskin, Lesse & Cosson client LECs. I have provided testimony in proceedings before the Indiana, Pennsylvania, Georgia, Missouri, Nebraska, Minnesota, Tennessee, Kansas, and New Mexico public service commissions. Finally, I have testified before the Federal-State Joint Board examining jurisdictional separations changes.

CERTIFICATE OF SERVICE

I hereby certify that on November 14, 2000, a copy of the foregoing document was served on the parties of record, via the method indicated:

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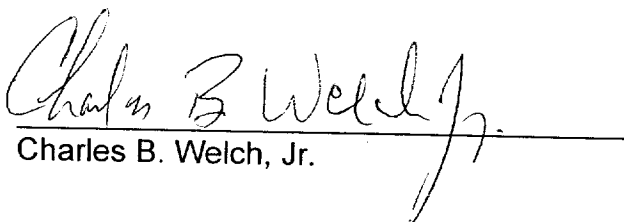
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